BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
HIRAM I. AND GRACE K. BANOFF)

Appearances:

For Appellants: Hiram I. and Grace K. Banoff, in pro. per.

For Respondent: James C. Stewart
Counsel

O P I N I O N

This appeal was originally made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Hiram I. and Grace K. Banoff against a proposed assessment of additional personal income tax in the amount of $375.00 for the year 1978. Subsequent to the filing of this appeal, appellants paid the proposed assessment in full. Accordingly, pursuant to section 19061.1 of the Revenue and Taxation Code, this appeal is treated as an appeal from the denial of a claim for refund.

Appellants, husband and wife/were both employed in New York before retirement, and after retirement moved to California. Appellant-wife, who was under 65 years of age in 1978, received a pension from the New York State public employee retirement system in the amount of $15,173.76 during the appeal year. Appellant-husband, who was over 65 in 1978, received over $5,000 in Social Security benefits during the year in issue. Appellants had no special agreement between themselves concerning the property interest in either the pension income or the Social Security benefits.

Pursuant to Revenue and Taxation Code section 17052.9, appellants claimed a $375.00 credit for the elderly based upon appellant-wife's New York state retirement income on their joint California personal income tax return For 1978. In computing the credit, appellants did not reduce appellant-wife's retirement income by any portion of the Social Security benefits received by appellant-husband. Upon examination of, their return, respondent determined that appellants had improperly allocated all of the aforementioned Social Security benefits to appellant-husband, rather than dividing them'equally between the spouses under California community property principles. When recomputed to reflect this allocation, appellants were not entitled to the claimed credit. Appellants' protest of respondent's action has resulted in this appeal.

The issue of whether Social Security benefits constitute community property or the separate property of the recipient for purposes of computing the subject tax credit has not previously been addressed by this board or the courts.

In the absence of an agreement between the spouses to the contrary, all property earned.by either spouse is treated as community property under California law. Each spouse is deemed to make an equal contribution to the marital enterprise, and therefore each is entitled to share equally in its assets. (Hisquierdo . Hisquierdo, 439 U.S. 572, 577-578 [59 L.Ed.2d 1] (1979).) Upon dissolution of a marriage, each spouse has an equal and absolute right to a half interest. in all community and quasi-community property. In contrast, each spouse retains his or her separate property, which includes assets the spouse owned before marriage or acquired separately during marriage through gift.

In In re Marriage of Brown, 15 Cal.3d 838 [126 Cal.Rptr. 633] (1976), the California Supreme Court held that any contractual rights of an employed spouse to participate in a pension program are community property if earned during marriage by labor *or* community property contributions. The court's decision was based upon the holding that contractual rights earned during marriage cannot be defeated by the employer's decision to cancel the pension program. In Brown, the court held that the husband, while not having worked the requisite period in order to be able to quit and still retain nonforfeitable rights under the pension plan, nonetheless did have enforceable rights if his employer attempted to terminate the pension plan:

> [O]nce the emloyee performed services in reliance upon the promised pension, he could enforce his right to a pension under traditional contract principles. of offer, acceptance and consideration or under the doctrine of promissory estoppel. ... [T]he courts have repeatedly reaffirmed that a non-vested pension right is nonetheless a contractual right, and thus a property right. (Brown, supra, 15 Cal.3d at p. 846.)

Since that property right was acquired by the husband during marriage and was not traceable to his separate property, it necessarily followed that the chose in action to protect continuation of the pension program was community property. However, while Brown held that nonvested pension "rights" could constitute community property, it does not follow that all such nonvested pension "rights" would constitute community property.

In recent California cases involving Old Age, Survivors, and Disability Insurance (OASDI) benefits under the federal Social Security Act, the courts have held that, in the context of a marriage dissolution proceeding, the community does not have an interest in future "nonvested" benefits. These decisions have been based chiefly on federal cases which have characterized Social Security as a general public benefit, creating no legally recognized property or contract right. (Weinberger v. Wiesenfeld, 420 U.S. 636, 647 [43 L.Ed.2d 514] (1975); Richardson v. Belcher, 404 U.S. 78, 81 [30 L.Ed.2d 231] (1971); Flemming v. Nestor, 363 U.S. 603, 610 [4 L.Ed.2d 1435] (1960).) An analysis of the application of California case law to the situation presented by this appeal requires a consideration of what it means to label OASDI benefits as noncontractual in nature.

The original federal social security legislation deliberately created a noncontractual program without vested rights. The intent of Congress was to prevent the legislation from being declared unconstitutional *on* the basis that the federal government had entered into the pension business. In Helvering v. Davis, 301 U.S. 619 [81 L.Ed. 13071, mod., 301 U.S. 672 (1937), the constitutionality of the 1935 social security legislation was upheld. The Court observed that "[t]he proceeds of both taxes [on employee and employer] are to be paid into the Treasury like internal-revenue taxes generally, and are not earmarked in any way." (Helvering v. Davis, supra, 301 U.S. 619, 635.) With. respect to the provision for paying old age "insurance" benefits, the court noted that "Congress may spend money in aid.of the 'general welfare'." (Helvering, supra, at p. 640.) Accordingly, Federal Insurance Contributions Act (FICA) taxes were not treated as pension contributions and OASDI benefits were not returns on an investment.

In Flemming v. Nestor, supra, the Court again applied the concept that OASDI benefits are governmental largess and not something "purchased"' by FICA taxes. The case involved the constitutionality of a Social Security Act amendment cutting off OASDI benefits to certain deported aliens who were otherwise eligible to receive benefits. With respect to the nature of the "rights" lost by deportation, the court observed:

> [E]ach worker's benefits, though flowing from the contributions he made to the national economy while actively employed, are not dependent on the degree to which he was called upon to support the system by taxation. It is apparent that the noncontractual interest of an employee covered by'the Act cannot be soundly analogized to that of the holder of an annuity, whose right to benefits is bottomed on his contractual premium payments. (Flemming v. Nestor, supra, 363 U.S. at pp. 609-610.)

The court also stressed that the anti-vesting provisions of the Social Security Act itself provided that the "tight to alter, amend, or repeal any provision". (42 U.S.C. § 1304) was reserved. Thus, future benefits that even a "fully insured" participant might receive were not proprietary or vested rights, and the cutting'off of the benefits involved no "taking" of property. Subsequent decisions of, the United States Supreme Court have consistently held that OASDI is noncontractual. (See,

e.g., Califano v. Goldfarb, 430 U.S. 199 [51 L.Ed.2d 270] (1977).) Recent California decisions dealing with the community or separate property classification of OASDI benefits are equally consistent. (In re Marriage of Hillerman, 109 Cal.App.3d 334 [167 Cal.Rptr. 2401 (1980); In re Marriage of Cohen, 105 Cal.App.3d 836 [164 Cal.Rptr. 672] (1980); In re Marriage of Nizenkoff, 65 Cal.App.3d 136 [135 Cal.Rptr. 189] (1976); In re Marriage of Kelley, 64 Cal.App.3d 82 [134 Cal. Rptr. 259] (1976).) These cases hold that the community has no interest in future OASDI benefits expected to be paid after divorce, even though the labor qualifying the employee for benefits, as well as the payment of FICA taxes, occurred during the marriage.

The authority cited above deals exclusively with future nonvested OASDI benefits expected to be paid after a divorce and is not controlling of a case dealing with the community or separate property classification of previously paid, and therefore, vested, Social Security benefits to a married spouse. The classification of such benefits for purposes of computing the subject tax credit is an issue which has not'been previously addressed.

Appellant's principal argument is that to sustain respondent's action and rule that OASDI benefits constitute community property would interfere "with the express statutory scheme of the Social Security Act and is forbidden by the supremacy clause of the United States Constitution ...."[1/] Appellants assert that close scrutiny of the Social Security Act reveals "numerous problems so complicated and so absurd as to lead to the conclusion [that] Congress intended to designate OASDI beneficiaries exclusive of any state domestic law." In support of this argument, appellants have relied upon the following case authority: McCarty v. McCarty, 453 U.S. 210 [69 L.Ed.2d 589] (1981); Hisquierdo v. Hisquierdo, supra; and In re Marriage of Hillerman, supra.

The court in Hillerman summarized the relevant case law with respect to the supremacy clause as follows:

1/ Article VI, clause 2, of the United States Constitution.

> State law which conflicts with a federal statute is invalid under the supremacy clause of the United States Constitution. (Footnote omitted.)
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> Congress acts against the background of state law [Citation]. [T]he whole subject of domestic relations is traditionally of local concern [Citation]. When state family law conflicts with a federal statute, preemption must be "positively required by direct enactment" of Congress [Citation], or must be the "clear and manifest" purpose of Congress [Citation] as evidenced by an "actual conflict" between the state and federal law [Citation] which does "major damage" to the "clear and substantial" governmental interests involved in the federal scheme [Citation]. Often courts will interpret federal statutes with the presumption Congress did not intend to interfere with the operation of state law [Citation]. (Hillerman, supra, at pp. 341-342.)

In finding preemption of California's community property law. in each of the three cases cited by appellants, the courts focused on specific provisions of the federal legislation'which conflicts with that law and noted the federal interest to which damage would be done if community property principles were applied. For example, in Hisquierdo v. Hisquierdo, supra, the Court found that the Railroad Retirement Act preempts California community property law because certain conflicting provisions in the federal legislation evidenced a congressional intent to subordinate state family law to the substantial federal interest in assuring rapid advancement of employees and more jobs for younger workers, in the railroad-industry. In McCarty v. McCarty, supra, the Court held: that the application of community property principles to military retired pay would do grave harm to the clear and su-bstantial federal interests of providing for the retired service member and meeting the personnel management needs of the active military forces. Finally, in Hillerman, supra, the court held that, in the context of a marriage dissolution proceeding, there were substantial conflicts between California community property law and the social security family benefit plan which make it impossible to characterize and divide future nonvested OASDI benefits as community property; the application of community property principles under such circumstances would do harm to a uniform federal system of distribution.

While appellants have forcefully and articulately advanced the proposition that the characterization of OASDI benefits as community property is, under all circumstances, prohibited by the supremacy clause, their reliance upon the authority they have cited in support of that contention is misplaced. Each of the three cases discussed above dealt with federal retirement benefits in the context of a marriage dissolution proceeding in which the application of community property principles would have caused serious damage to specific federal interests. We are aware of no "clear and substantial" federal interest to which "major damage" would be done by the application of community property principles under the circumstances presented by this appeal, and appellants have cited no provision in the Social Security Act with which respondent's action in this matter would conflict. Accordingly, we must disagree with appellants with respect to their argument that, in all cases, the provisions of the Social Security Act preempt California's community property law.

The alternative argument advanced by appellants is that the characterization of the subject social security benefits as community property is improper because the right thereto "vested" out of labor performed in New York, a common law state. For the reasons set forth above in our discussion of the noncontractual nature of OASDI benefits, we find appellants' argument to be without merit. Contrary to their contention that such benefits "vest," the authority we have cited clearly stands for the proposition that OASDI benefits are: (i) noncontractual in nature; (ii) constitute payments made in the "general welfare," and (iii) that a recipient has no "right" to a benefit payment until it has been made. (See, e.g., Flemming v. Nestor, supra.) For the same reasons that we reject appellants' argument, we must conclude that respondent's action in this matter be sustained. Appellant-husband's right to the subject OASDI benefits vested upon receipt, at a time when he and his spouse were married and living together in a community property state without a special agreement concerning the nature of the benefit payments. Accordingly, those benefit payments constituted community property. (Civ. Code, §§ 5110, 5118; see In re Marriage of Jafeman, 29 Cal.App.3d 244 [105 Cal.Rptr. 483] (1972).)

Appeal of Hiram I. and Grace K. Banoff

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS 'HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Hiram I. and Grace K. Banoff for refund of personal income tax in the amount of $375.00 for the year 1978, be and the same is hereby sustained.

Done at Sacramento, California, this 5th day of April , 1983, by the. State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg, Mr. Nevins and Mr. Harvey present.

William M Bennett , Chairman

Conway H. Collis , Member

Ernest J. Dronenburg, Jr. , Member

Richard Nevins , Member

Walter Harvey* , Member

*For Kenneth Cory, per Government Code Section 7.9